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DOD FINANCIAL MANAGEMENT

Integrated Approach, Accountability, Transparency, and Incentives Are Keys to Effective Reform

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Abstract It is a pleasure to be here to discuss financial management at the Department of Defense (DOD). Today, DOD faces financial management problems that are pervasive, complex, long-standing, and deeply rooted in virtually all business operations throughout the department. DOD's financial management deficiencies, taken together, represent the single largest obstacle to achieving an unqualified opinion on the U.S. government's consolidated financial statements. To date, none of the military services or major DOD components have passed the test of an independent financial audit because of pervasive weaknesses in financial management systems, operations, and controls.		
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Mr. Chairman and Members of the Subcommittee:

It is a pleasure to be here to discuss financial management at the Department of Defense (DOD). Today, DOD faces financial management problems that are pervasive, complex, long-standing, and deeply rooted in virtually all business operations throughout the department. DOD's financial management deficiencies, taken together, represent the single largest obstacle to achieving an unqualified opinion on the U.S. government's consolidated financial statements. To date, none of the military services or major DOD components have passed the test of an independent financial audit because of pervasive weaknesses in financial management systems, operations, and controls.

Overhauling financial management represents a major management challenge that goes far beyond financial accounting to the very fiber of the department's range of business operations and management culture. Previous administrations over the past several decades have tried to address these problems in various ways but have largely been unsuccessful. In this regard, on September 10, 2001, Secretary of Defense Rumsfeld announced a broad initiative intended to "transform the way the department works and what it works on" which he estimated could save 5 percent of DOD's budget—or an estimated \$15 to \$18 billion annually. The Secretary recognized that transformation would be difficult and expected the needed changes would take 8 or more years to complete.

The President's *Management Agenda* includes improved financial management performance as one of his five governmentwide management goals. In addition, in August 2001, the Principals of the Joint Financial Management Improvement Program—the Secretary of the Treasury, the Director of the Office of Management and Budget, the Director of the Office of Personnel Management, and the Comptroller General—began a series of quarterly meetings that marked the first time all four of the Principals had gathered together in over 10 years. To date, these sessions have resulted in substantive deliberations and agreements focused on key issues such as better defining measures for financial management success. These measures include being able to routinely provide timely, reliable, and useful financial information and having no material internal control weaknesses. Success on these measures will be a significant challenge to DOD. The principals have invited Defense Comptroller Zakheim to their upcoming April 2002 meeting to discuss the department's transformation effort and to begin a constructive engagement with DOD on this important initiative.

With the events of September 11, and the federal government's short- and long-term budget challenges, it is more important than ever that DOD effectively transform its business processes to ensure that it gets the most from every dollar spent. The department must be able to effectively carry out its stewardship responsibilities for the funding it receives and for the vast amount of equipment and inventories used in support of military operations. Even before the events of September 11, increased globalization, changing security threats, and rapid technological advances were prompting fundamental changes in the environment in which DOD operates. These trends place a premium on increasing strategic planning, enhancing results orientation, ensuring effective accountability, maintaining transparency, and using integrated approaches. Six of the 22 areas on GAO's governmentwide "high-risk" list are DOD program areas, and DOD shares responsibility for 2 other high-risk areas that are governmentwide in scope.¹ Central to effectively addressing DOD's financial management problems will be the understanding that these eight areas are interrelated and cannot be addressed in an isolated, stovepiped, or piecemeal fashion.

The recent success of our forces in Afghanistan has again demonstrated the unparalleled excellence of our military forces. This same level of excellence is not yet evident in the department's financial management and other business processes. This is particularly problematic because effective financial management operations are critical to achieving the department's mission in a reasonably economical, efficient, and effective manner and to providing reliable, timely financial information on a routine basis to support management decision-making at all levels throughout DOD. This level of excellence will also be critical in order to enhance overall transparency and accountability. Success in this area will serve to free up resources that can be redeployed to enhance readiness, improve the quality of life for our troops and their families, and reduce the gap between wants and available funding in connection with major weapon systems.

Today, I will provide my perspectives on (1) how Defense got where it is today and the underlying causes of the department's longstanding inability to effectively reform its financial management and other business systems and processes and (2) the keys to successfully carrying out the Secretary's business process transformation and DOD's plans and actions to date. Last

¹U.S. General Accounting Office, *High-Risk Series: An Update*, GAO-01-263 (Washington, D.C.: Jan. 2001).

summer, the Comptroller General shared with Secretary Rumsfeld and Comptroller Zakheim a business transformation paper. This paper provided an overview of GAO's views on the current challenges facing the department, the keys to effective reform, and detailed one option for addressing these challenges.

Long-Standing Financial Management Problems and Attempts at Reform

History is a good teacher. To solve the problems of today, it is instructive to look to the past. The problems with the department's financial management operations date back decades, and previous attempts at reform have largely proven unsuccessful. These problems adversely affect DOD's ability to control costs, ensure basic accountability, anticipate future costs and claims on the budget (such as for health care, weapon systems, and environmental liabilities), measure performance, maintain funds control, prevent fraud, and address pressing management issues.

In this regard, I would like to briefly highlight three of our recent products that exemplify the adverse impact of DOD's reliance on fundamentally flawed financial management systems and processes and a weak overall internal control environment.

- In a testimony before your subcommittee last week,² we highlighted continuing problems with internal controls over approximately \$64 million in fiscal year 2001 purchase card transactions involving two Navy activities. Consistent with our testimony last July³ on fiscal year 2000 purchase card transactions at these locations, our follow-up review demonstrated that continuing control problems left these Navy activities vulnerable to fraudulent, improper, and abusive purchases and theft and misuse of government property. We are currently auditing purchase card usage across the department.
- In a testimony before your Subcommittee in July 2001, we reported⁴ that DOD did not have adequate systems, controls, and managerial attention

²U.S. General Accounting Office, *Purchase Cards: Continued Control Weaknesses Leave Two Navy Units Vulnerable to Fraud and Abuse*, GAO-02-504T (Washington, D.C.: Mar. 13, 2002).

³U.S. General Accounting Office, *Purchase Cards: Control Weaknesses Leave Two Navy Units Vulnerable to Fraud and Abuse*, GAO-01-995T (Washington, D.C.: July 30, 2001).

⁴U.S. General Accounting Office, *Canceled DOD Appropriations: \$615 Million of Illegal or Otherwise Improper Adjustments*, GAO-01-994T (Washington, D.C.: July 26, 2001).

to ensure that \$2.7 billion of adjustments to closed appropriations were legal and otherwise proper. Our review of \$2.2 billion of these adjustments found that about \$615 million of them should not have been made, including about \$146 million that were illegal.

- In June 2001, we reported⁵ that DOD's current financial systems could not adequately track and report on whether the \$1.1 billion in earmarked funds that the Congress provided to DOD for spare parts and associated logistical support were actually used for the intended purpose. The vast majority of the funds—92 percent—were transferred to the military services operation and maintenance accounts. We found that once these funds were transferred, DOD lost its ability to assure the Congress that the funds it received for spare parts purchases were used for, and only for, that purpose.

Problems with the department's financial management operations go far beyond its accounting and finance systems and processes. The department continues to rely on a far-flung, complex network of finance, logistics, personnel, acquisition, and other management information systems—80 percent of which are not under the control of the DOD Comptroller—to gather the financial data needed to support day-to-day management decisionmaking. This network was not designed to be, but rather has evolved into, the overly complex and error-prone operation that exists today, including (1) little standardization across DOD components, (2) multiple systems performing the same tasks, (3) the same data stored in multiple systems, (4) manual data entry into multiple systems, and (5) a large number of data translations and interfaces that combine to exacerbate problems with data integrity. DOD has determined, for example, that efforts to reconcile a single contract involving 162 payments resulted in an estimated 15,000 adjustments.

⁵U.S. General Accounting Office, *Defense Inventory: Information on the Use of Spare Parts Funding Is Lacking*, GAO-01-472 (Washington, D.C.: June 11, 2001).

Many of the department's business processes in operation today are mired in old, inefficient processes and legacy systems, some of which go back to the 1950s and 1960s. For example, while implemented in 1968, the department still relies on the Mechanization of Contract Administration Services (MOCAS) system to process a substantial portion of the contract payment transactions for all DOD organizations. In fiscal year 2001, MOCAS processed an estimated \$78 billion in contract payments. Past efforts to replace MOCAS have failed. Most recently, in 1994, DOD began acquiring the Standard Procurement System (SPS) to replace the contract administration functions currently performed by MOCAS. However, our July 2001 and February 2002 reporting⁶ on DOD's \$3.7 billion investment in SPS showed that this substantial investment was not economically justified and raised questions as to whether further investment in SPS was justified. For the foreseeable future, DOD will continue to be saddled with MOCAS.

Moving to the 1970s, we, the Defense Inspector General, and the military service audit organizations, issued numerous reports detailing serious problems with the department's financial management operations. For example, between 1975 and 1981, we issued more than 75 reports documenting serious problems with DOD's existing cost, property, fund control, and payroll accounting systems. In the 1980s, we found that despite the billions of dollars invested in individual systems, these efforts, too, fell far short of the mark, with extensive schedule delays and cost overruns. For example, in 1989, our report⁷ on eight major DOD system development efforts—including two major accounting systems—under way at that time, showed that system development cost estimates doubled, two of the eight efforts were abandoned, and the remaining six efforts experienced delays of from 3 to 7 years.

Beginning in the 1990s, following passage of the Chief Financial Officers (CFO) Act of 1990, there was a recognition in DOD that broad-based financial management reform was needed. Over the past 12 years, the department has initiated several departmentwide reform initiatives intended to fundamentally reform its financial operations as well as other

⁶U.S. General Accounting Office, *DOD Systems Modernization: Continued Investment in the Standard Procurement System Has Not Been Justified*, GAO-01-682 (Washington, D.C.: July 31, 2001) and *DOD's Standard Procurement System: Continued Investment Has Yet to Be Justified*, GAO-02-392T (Washington, D.C.: Feb. 7, 2002).

⁷U.S. General Accounting Office, *Automated Information Systems: Schedule Delays and Cost Overruns Plague DOD Systems*, GAO/IMTEC-89-36 (Washington, D.C.: May 10, 1989).

key business support processes, including the Corporate Information Management initiative, the Defense Business Operations Fund, and the Defense Reform Initiative. These efforts, which I will highlight today, have proven to be unsuccessful despite good intentions and significant effort. The conditions that led to these previous attempts at reform remain largely unchanged today.

Corporate Information Management. The Corporate Information Management (CIM), initiative, begun in 1989, was expected to save billions of dollars by streamlining operations and implementing standard information systems. CIM was expected to reform all DOD's functional areas—including finance, procurement, material management, and human resources—through consolidating, standardizing, and integrating information systems. DOD also expected CIM to replace approximately 2,000 duplicative systems. Over the years, we have made numerous recommendations to improve CIM's management, but these recommendations were largely not addressed. Instead, DOD spent billions of dollars with little sound analytical justification. We reported in 1997,⁸ that 8 years after beginning CIM, and spending about \$20 billion on the initiative, expected savings had yet to materialize. The initiative was eventually abandoned.

Defense Business Operations Fund. In October 1991, DOD established a new entity, the Defense Business Operations Fund by consolidating nine existing industrial and stock funds and five other activities operated throughout DOD. Through this consolidation, the fund was intended to bring greater visibility and management to the overall cost of carrying out certain critical DOD business operations. However, from its inception, the fund was plagued by management problems. In 1996, DOD announced the fund's elimination. In its place, DOD established four working capital funds. These new working capital funds inherited their predecessor's operational and financial reporting problems.

⁸U.S. General Accounting Office, *High-Risk Series: Information Management and Technology*, GAO/HR-97-9 (Washington, D.C.: Feb. 1997).

Defense Reform Initiative (DRI). In announcing the DRI program in November 1997, the then Secretary of Defense stated that his goal was “to ignite a revolution in business affairs.” DRI represented a set of proposed actions aimed at improving the effectiveness and efficiency of DOD’s business operations, particularly in areas that have been long-standing problems—including financial management. In July 2000, we reported⁹ that while DRI got off to a good start and made progress in implementing many of the component initiatives, it did not meet expected time frames and goals, and the extent to which savings from these initiatives will be realized is yet to be determined. GAO is currently examining the extent to which DRI efforts begun under the previous administration are continuing.

The past has clearly taught us that addressing DOD’s serious financial management problems will not be easy. Early in his tenure, Secretary Rumsfeld commissioned a new study of the department’s financial management operations. The report on the results of the study, *Transforming Department of Defense Financial Management: A Strategy for Change*, was issued on April 13, 2001. The report recognized that the department will have to undergo “a radical financial management transformation” and that it would take more than a decade to achieve. The report concluded that many studies and interviews with current and former leaders in DOD point to the same problems and frustrations, and that repeated audit reports verify systemic problems illustrating the need for radical transformation in order to achieve success. Secretary Rumsfeld further confirmed the need for a fundamental transformation of DOD in his “top-down” Quadrennial Defense Review. Specifically, his September 30, 2001, *Quadrennial Defense Review Report* concluded that the department must transform its outdated support structure, including decades-old financial systems that are not well interconnected. The report summed up the challenge well in stating: “While America’s businesses have streamlined and adopted new business models to react to fast-moving changes in markets and technologies, the Defense Department has lagged behind without an overarching strategy to improve its business practices.”

⁹U.S. General Accounting Office, *Defense Management: Actions Needed to Sustain Reform Initiatives and Achieve Greater Results*, GAO/NSIAD-00-72 (Washington, D.C.: July 25, 2000).

Underlying Causes of Financial and Related Business Process Reform Challenges

As part of our constructive engagement approach with DOD, the Comptroller General met with Secretary Rumsfeld last summer to provide our perspectives on the underlying causes of the problems that have impeded past reform efforts at the department and to discuss options for addressing these challenges. There are four underlying causes

- a lack of sustained top-level leadership and management accountability for correcting problems;
- deeply embedded cultural resistance to change, including military service parochialism and stovepiped operations;
- a lack of results-oriented goals and performance measures and monitoring; and
- inadequate incentives for seeking change.

Lack of Leadership and Accountability

Historically, DOD has not routinely assigned accountability for performance to specific organizations or individuals that have sufficient authority to accomplish desired goals. For example, under the CFO Act, it is the responsibility of agency CFOs to establish the mission and vision for the agency's future financial management. However, at DOD, the Comptroller—who is by statute the department's CFO—has direct responsibility for only an estimated 20 percent of the data relied on to carry out the department's financial management operations. The department has learned through its efforts to meet the Year 2000 computing challenge that to be successful, major improvement initiatives must have the direct, active support and involvement of the Secretary and Deputy Secretary of Defense. In the Year 2000 case, the then Deputy Secretary of Defense was personally and substantially involved and played a major role in the department's success. Such top-level support and attention helps ensure that daily activities throughout the department remain focused on achieving shared, agencywide outcomes. A central finding from our report on our survey of best practices of world-class financial management organizations—Boeing; Chase Manhattan Bank; General Electric; Pfizer; Hewlett-Packard; Owens Corning; and the states of Massachusetts, Texas, and Virginia—was that clear, strong executive leadership was essential to (1) making financial management an entitywide priority, (2) redefining the

role of finance, (3) providing meaningful information to decisionmakers, and (4) building a team of people that deliver results.¹⁰

DOD past experience has suggested that top management has not had a proactive, consistent, and continuing role in building capacity, integrating daily operations for achieving performance goals, and creating incentives. Sustaining top management commitment to performance goals is a particular challenge for DOD. In the past, the average 1.7-year tenure of the department's top political appointees has served to hinder long-term planning and follow-through.

Cultural Resistance and Parochialism

Cultural resistance to change and military service parochialism have also played a significant role in impeding previous attempts to implement broad-based management reforms at DOD. The department has acknowledged that it confronts decades-old problems deeply grounded in the bureaucratic history and operating practices of a complex, multifaceted organization, and that many of these practices were developed piecemeal and evolved to accommodate different organizations, each with its own policies and procedures.

For example, as discussed in our July 2000 report,¹¹ the department encountered resistance to developing departmentwide solutions under the then Secretary's broad-based DRI.¹² In 1997, the department established a Defense Management Council—including high-level representatives from each of the military services and other senior executives in the Office of the Secretary of Defense—which was intended to serve as the "board of directors" to help break down organizational stovepipes and overcome cultural resistance to changes called for under DRI. However, we found that the council's effectiveness was impaired because members were not able to put their individual military services' or DOD agencies' interests aside to focus on department-wide approaches to long-standing problems.

¹⁰U.S. General Accounting Office, *Executive Guide: Creating Value Through World-class Financial Management*, GAO/AIMD-00-134 (Washington, D.C.: Apr. 2000).

¹¹GAO/NSIAD-00-72.

¹²Announced by the Secretary of Defense in 1997, DRI represents a set of actions aimed at reforming the department's major business processes and support operations.

We have also seen an inability to put aside parochial views. Cultural resistance to change has impeded reforms not only in financial management, but also in other business areas, such as weapon system acquisition and inventory management. For example, as we reported¹³ last year, while the individual military services conduct considerable analyses justifying major acquisitions, these analyses can be narrowly focused and do not consider joint acquisitions with the other services. In the inventory management area, DOD's culture has supported buying and storing multiple layers of inventory rather than managing with just the amount of stock needed.

Unclear Goals and Performance Measures

Further, DOD's past reform efforts have been handicapped by the lack of clear, linked goals and performance measures. As a result, DOD managers lack straightforward road maps showing how their work contributes to attaining the department's strategic goals, and they risk operating autonomously rather than collectively. In some cases, DOD had not yet developed appropriate strategic goals, and in other cases, its strategic goals and objectives were not linked to those of the military services and defense agencies.

As part of our assessment of *DOD's Fiscal Year 2000 Financial Management Improvement Plan*, we reported¹⁴ that, for the most part, the plan represented the military services' and Defense components' stovepiped approaches to reforming financial management and did not clearly articulate how these various efforts would collectively result in an integrated DOD-wide approach to financial management improvement. In addition, we reported that the department's plan did not include performance measures that could be used to assess DOD's progress in resolving its financial management problems. DOD officials have informed us that they are now working to revise the department's approach to this plan so that future years' updates will reflect a more strategic, departmentwide vision and provide a more effective tool for financial management reform.

¹³U.S. General Accounting Office, *Major Management Challenges and Program Risks: Department of Defense*, GAO-01-244 (Washington D.C.: Jan. 2001).

¹⁴U.S. General Accounting Office, *Financial Management: DOD Improvement Plan Needs Strategic Focus*, GAO-01-764 (Washington D.C.: Aug. 17, 2001).

As it moves to modernize its systems, the department faces a formidable challenge in responding to technological advances that are changing traditional approaches to business management. For fiscal year 2001, DOD's reported total information technology investments of almost \$23 billion supporting a wide range of military operations as well as DOD business functions. As we have reported,¹⁵ while DOD plans to invest billions of dollars in modernizing its financial management and other business support systems, it does not yet have an overall blueprint—or enterprise architecture—in place to guide and direct these investments. As we recently testified,¹⁶ our review of practices at leading organizations showed they were able to make sure their business systems addressed corporate—rather than individual business unit—objectives by using enterprise architectures to guide and constrain investments. Consistent with our recommendation, DOD is now working to develop a financial management enterprise architecture, which is a very positive development.

Lack of Incentives for Change

The final underlying cause of the department's long-standing inability to carry out needed fundamental reform has been the lack of incentives for making more than incremental change to existing "business-as-usual" processes, systems, and structures. Traditionally, DOD has focused on justifying its need for more funding rather than on the outcomes its programs have produced. DOD generally measures its performance by the amount of money spent, people employed, or number of tasks completed. Incentives for its decision makers to implement changed behavior have been minimal or nonexistent. Secretary Rumsfeld perhaps said it best in announcing his planned transformation at DOD: "There will be real consequences from, and real resistance to, fundamental change."

This lack of incentive has perhaps been most evident in the department's acquisition area. In DOD's culture, the success of a manager's career has depended more on moving programs and operations through the DOD process rather than on achieving better program outcomes. The fact that a given program may have cost more than estimated, taken longer to complete, and not generated results or performed as promised was

¹⁵U.S. General Accounting Office, *Information Technology: Architecture Needed to Guide Modernization of DOD's Financial Operations*, GAO-01-525 (Washington, D.C.: May 17, 2001).

¹⁶U.S. General Accounting Office, *Defense Acquisitions: DOD Faces Challenges in Implementing Best Practices*, GAO-02-469T (Washington, D.C.: Feb. 27, 2002).

secondary to fielding a new program. To effect real change, actions are needed to (1) break down parochialism and reward behaviors that meet DOD-wide and congressional goals; (2) develop incentives that motivate decisionmakers to initiate and implement efforts that are consistent with better program outcomes, including saying “no” or pulling the plug on a system or program that is failing; and (3) facilitate a congressional focus on results-oriented management, particularly with respect to resource allocation decisions.

Keys To Fundamental DOD Financial Management Reform

As we testified before your Subcommittee last May,¹⁷ our experience has shown there are several key elements that, collectively would enable the department to effectively address the underlying causes of its inability to resolve its long-standing financial management problems. These elements, which are key to any successful approach to financial management reform, include

- addressing the department’s financial management challenges as part of a comprehensive, integrated, DOD-wide business process reform;
- providing for sustained leadership by the Secretary of Defense and resource control to implement needed financial management reforms;
- establishing clear lines of responsibility, authority, and accountability for such reform tied to the Secretary;
- incorporating results-oriented performance measures and monitoring tied to financial management reforms;
- providing appropriate incentives or consequences for action or inaction;
- establishing an enterprisewide system architecture to guide and direct financial management modernization investments; and
- ensuring effective oversight and monitoring.

Actions on many of the key areas central to successfully achieving desired financial management and related business process transformation goals—particularly those that rely on longer term systems improvements—will take a number of years to fully implement. Secretary Rumsfeld has estimated that his envisioned transformation may take 8 or more years to complete. Consequently, both long-term actions focused on the Secretary’s envisioned business transformation and short-term actions focused on

¹⁷U.S. General Accounting Office, *DOD Financial Management: Integrated Approach, Accountability, and Incentives Are Keys to Effective Reform*, GAO-01-681T (Washington, D.C.: May 8, 2001).

improvements within existing systems and processes will be critical going forward. Short-term actions in particular will be critical if the department is to achieve the greatest possible accountability over existing resources and more reliable data for day-to-day decisionmaking while longer-term systems and business process reengineering efforts are under way.

Beginning with the Secretary's recognition of a need for a fundamental transformation of the department's business processes, and building on some of the work begun under past administrations, DOD has taken a number of positive steps in many of these key areas. At the same time, the challenges remaining in each of these key areas are daunting.

Integrated Business Process Reform Strategy

As we have reported in the past,¹⁸ establishing the right goal is essential for success. Central to effectively addressing DOD's financial management problems will be the recognition that they cannot be addressed in an isolated, stovepiped, or piecemeal fashion separate from the other high-risk areas facing the department.¹⁹ Successfully reengineering the department's processes supporting its financial management and other business support operations will be critical if DOD is to effectively address the deep-rooted organizational emphasis on maintaining business-as-usual across the department.

¹⁸U.S. General Accounting Office, *Department of Defense: Progress in Financial Management Reform*, GAO/T-AIMD/NSIAD-00-163 (Washington, D.C.: May 9, 2000).

¹⁹The eight interrelated high-risk areas that represent the greatest challenge to DOD's developing world-class business operations supporting its forces are: financial management, human capital, information security, systems modernization, weapon system acquisition, contract management, infrastructure management, and inventory management.

Financial management is a crosscutting issue that affects virtually all of DOD's business areas. For example, improving its financial management operations so that they can produce timely, reliable, and useful cost information will be essential if the department is to effectively measure its progress toward achieving many key outcomes and goals across virtually the entire spectrum of DOD's business operations. At the same time, the department's financial management problems—and, most importantly, the keys to their resolution—are deeply rooted in and dependent upon developing solutions to a wide variety of management problems across DOD's various organizations and business areas. For example, we have reported²⁰ that many of DOD's financial management shortcomings were attributable in part to human capital issues. The department does not yet have a strategy in place for improving its financial management human capital. This is especially critical in connection with DOD's civilian workforce, since DOD has generally done a much better job in conjunction with human capital planning for its military personnel. In addition, DOD's civilian personnel face a variety of size, shape, skills, and succession-planning challenges that need to be addressed.

As I mentioned earlier, and it bears repetition, the department has reported that an estimated 80 percent of the data needed for sound financial management comes from its other business operations, such as its acquisition and logistics communities. DOD's vast array of costly, nonintegrated, duplicative, and inefficient financial management systems is reflective of its lack of an enterprisewide, integrated approach to addressing management challenges. DOD has acknowledged that one of the reasons for the lack of clarity in its reporting under the Government Performance and Results Act has been that most of the program outcomes the department is striving to achieve are interrelated, while its management systems are not integrated.

As I discussed previously, the Secretary of Defense has made the fundamental transformation of business practices throughout the department a top priority. In this context, the Secretary established a number of top-level committees, councils, and boards, including the Senior Executive Committee, Business Initiative Council, and Defense Business Practices Implementation Board. The Senior Executive Committee was established to help guide efforts across the department to improve its business practices. This committee—chaired by the Secretary of Defense,

²⁰GAO-01-244.

and with membership to include the Deputy Secretary, the military service secretaries, and the Under Secretary of Defense for Acquisition, Logistics and Technology—was established to function as the board of directors for the department. The Business Initiative Council—comprising the military service secretaries and headed by the Under Secretary of Defense for Acquisition, Technology and Logistics—was established to encourage the military services to explore new money saving business practices to help offset funding requirements for transformation and other initiatives. The Secretary also established the Defense Business Practices Implementation Board, composed of business leaders from the private sector. The board is intended to tap outside expertise to advise the department on its efforts to improve business practices.

Active Leadership and Resource Control

The department's successful Year 2000 effort illustrated, and our survey of leading financial management organizations²¹ captured, the importance of strong leadership from top management. As we have stated many times before, strong, sustained executive leadership is critical to changing a deeply rooted corporate culture—such as the existing “business as usual” culture at DOD—and to successfully implementing financial management reform. As I mentioned earlier, the personal, active involvement of the Deputy Secretary of Defense played a key role in building entitywide support and focus for the department's Year 2000 initiatives. Given the long-standing and deeply entrenched nature of the department's financial management problems—combined with the numerous competing DOD organizations, each operating with varying, often parochial views and incentives—such visible, sustained top-level leadership will be critical.

²¹GAO/AIMD-00-134.

In discussing their April 2001 report to the Secretary of Defense on transforming financial management,²² the authors stated that, “unlike previous failed attempts to improve DOD’s financial practices, there is a new push by DOD leadership to make this issue a priority.” With respect to the key area of investment control, the Secretary took action to set aside \$100 million for financial modernization. Strong, sustained executive leadership—over a number of years and administrations—will be key to changing a deeply rooted culture. In addition, given that significant investments in information systems and related processes have historically occurred in a largely decentralized manner throughout the department, additional actions will likely be required to implement a centralized IT investment control strategy. For example, in our May 2001 report,²³ we recommended that DOD take action to establish centralized control over transformation investments to ensure that funding is provided for only those proposed investments in systems and business processes that are consistent with the department’s overall business process transformation strategy.

Clear Lines of Responsibility and Accountability

Last summer, when the Comptroller General met with Secretary Rumsfeld, he stressed the importance of establishing clear lines of responsibility, decision-making authority, and resource control for actions across the department tied to the Secretary as a key to reform. As we previously reported,²⁴ such an accountability structure should emanate from the highest levels and include the secretary of each of the military services as well as heads of the department’s various major business areas.

The Secretary of Defense has taken action to vest responsibility and accountability for financial management modernization with the DOD Comptroller. In October 2001, the DOD Comptroller established the Financial Management Modernization Executive and Steering Committees as the governing bodies that oversee the activities related to this modernization effort and also established a supporting working group to provide day-to-day guidance and direction in these efforts. DOD reports

²²Department of Defense, *Transforming Department of Defense Financial Management: A Strategy for Change*, (Washington, D.C.: Apr. 13, 2001).

²³GAO-01-525.

²⁴GAO/NSIAD-00-72.

that the executive and steering committees met for the first time in January 2002.

It is clear to us that the Comptroller has the full support of the Secretary and that the Secretary is committed to making meaningful change. To make this work, it is important that the Comptroller have sufficient authority to bring about the full, effective participation of the military services and business process owners across the department. The Comptroller has direct control of 20 percent of the data needed for sound financial management and has historically had limited ability to control information technology investments across the department. Addressing issues such as centralization of authority for information systems investments and continuity of leadership are critical to successful business process transformation.

In addition to DOD, a number of other federal departments and agencies are facing an array of interrelated business system management challenges for which resolution is likely to require a number of years, challenges that could span administrations. One option that may have merit would be the establishment of chief operating officers, who could be appointed for a set term of 5 to 7 years with the potential for reappointment. These individuals should have a proven track record as a business process change agents for large, diverse organizations and would spearhead business process transformation across the department or agency.

Results-Oriented Performance

As discussed in our January 2001 report on DOD's major performance and accountability challenges,²⁵ establishing a results orientation is another key element of any approach to reform. Such an orientation should draw upon results that could be achieved through commercial best practices, including outsourcing and shared servicing concepts. Personnel throughout the department must share the common goal of establishing financial management operations that not only produce financial statements that can withstand the test of an audit but, more importantly, routinely generate useful, reliable, and timely financial information for day-to-day management purposes.

²⁵GAO-01-244.

In addition, we have previously testified²⁶ that DOD's financial management improvement efforts should be measured against an overall goal of effectively supporting DOD's basic business processes, including appropriately considering related business process system interrelationships, rather than determining system-by-system compliance. Such a results-oriented focus is also consistent with an important lesson learned from the department's Year 2000 experience. DOD's initial Year 2000 focus was geared toward ensuring compliance on a system-by-system basis and did not appropriately consider the interrelationships of systems and business areas across the department. It was not until the department, under the direction of the then Deputy Secretary, shifted to a core mission and function review approach that it was able to achieve the desired result of greatly reducing its Year 2000 risk.

Since the Secretary has established an overall business process transformation goal that will require a number of years to achieve, going forward, it is especially critical for managers throughout the department to focus on specific measurable metrics that, over time, collectively will translate to achieving this overall goal. It is important for the department to refocus its annual accountability reporting on this overall goal of fundamentally transforming the department's financial management systems and related business processes to include appropriate interim annual measures for tracking progress toward this goal.

In the short term, it is important to focus on actions that can be taken using existing systems and processes. It is critical to establish interim measures to both track performance against the department's overall transformation goals and facilitate near-term successes using existing systems and processes. The department has established an initial set of metrics intended to evaluate financial performance, and it reports that it has seen improvements. For example, with respect to closed appropriation accounts, DOD reported during the first 4 months of fiscal year 2002 a reduction in the dollar value of adjustments to closed appropriation accounts of about 51 percent from the same 4-month period in fiscal year 2001. Other existing metrics concern cash and funds management, contract and vendor payments, and disbursement accounting. DOD also reported that it is working to develop these metrics into higher-level measures more appropriate for senior management. We agree with the

²⁶GAO/T-AIMD/NSIAD-00-163.

department's efforts to expand the use of appropriate metrics to guide its financial management reform efforts.

Incentives and Consequences

Another key to breaking down the parochial interests and stovepiped approaches that have plagued previous reform efforts is establishing mechanisms to reward organizations and individuals for behaviors that comply with DOD-wide and congressional goals. Such mechanisms should be geared to providing appropriate incentives and penalties to motivate decision makers to initiate and implement efforts that result in fundamentally reformed financial management and other business support operations.

In addition, such incentives and consequences are essential if DOD is to break down the parochial interests that have plagued previous reform efforts. Incentives driving traditional ways of doing business, for example, must be changed, and cultural resistance to new approaches must be overcome. Simply put, DOD must convince people throughout the department that they must change from business-as-usual systems and practices or they are likely to face serious consequences, organizationally and personally.

Enterprise Architecture

Establishing and implementing an enterprisewide financial management architecture is essential for the department to effectively manage its large, complex system modernization effort now under way. The Clinger-Cohen Act requires agencies to develop, implement, and maintain an integrated system architecture. As we previously reported,²⁷ such an architecture can help ensure that the department invests only in integrated, enterprisewide business system solutions and, conversely, will help move resources away from non-value-added legacy business systems and nonintegrated business system development efforts. In addition, without an architecture, DOD runs the serious risk that its system efforts will perpetuate the existing system environment that suffers from systems duplication, limited interoperability, and unnecessarily costly operations and maintenance. In our May 2001 report,²⁸ we pointed out that DOD lacks a financial management enterprise architecture to guide and constrain the billions of

²⁷GAO/T-AIMD/NSIAD-00-163.

²⁸GAO-01-525.

dollars it plans to spend to modernize its financial management operations and systems.

DOD has reported that it is in the process of contracting for the development of a DOD-wide financial management enterprise architecture to “achieve the Secretary’s vision of relevant, reliable and timely financial information needed to support informed decision-making.” Consistent with our previous recommendations in this area, DOD has begun an extensive effort to document the department’s current as-is financial management architecture by inventorying systems now relied on to carry out financial management operations throughout the department. DOD has identified 674 top-level systems and at least 997 associated interfaces thus far and estimates that this inventory could include up to 1,000 systems when completed.

While DOD’s beginning efforts at developing a financial management enterprise architecture are off to a good start, the challenges yet confronting the department in its efforts to fully develop, implement, and maintain a DOD-wide financial management enterprise architecture are unprecedented. Our May 2001 report²⁹ details a series of recommended actions directed at ensuring DOD employs recognized best practices for enterprise architecture management. This effort will be further complicated as the department strives to develop multiple enterprise architectures across its various business areas. For example, in June 2001, we recommended³⁰ that DOD develop an enterprise architecture for its logistics operations. As I discussed previously, an integrated reform strategy is critical. In this context, it is essential that DOD closely coordinate and integrate the development and implementation of these, as well as other, architectures. By following this integrated approach and our previous recommendations, DOD will be in the best position to avoid the serious risk that, after spending billions of dollars on systems modernization, it will perpetuate the existing systems environment that suffers from duplication of systems, limited interoperability, and unnecessarily costly operations and maintenance.

²⁹GAO-01-525.

³⁰U.S. General Accounting Office, *Information Technology: DLA Should Strengthen Business Systems Modernization Architecture and Investment Activities*, GAO-01-631 (Washington, D.C.: June 29, 2001).

Monitoring and Oversight

Ensuring effective monitoring and oversight of progress will also be a key to bringing about effective implementation of the department's financial management and related business process reform. We have previously testified³¹ that periodic reporting of status information to department top management, the Office of Management and Budget (OMB), the Congress, and the audit community is another key lesson learned from the department's successful effort to address its Year 2000 challenge.

Previous submissions of its *Financial Management Improvement Plan* have simply been compilations of data call information on the stovepiped approaches to financial management improvements received from the various DOD components. It is our understanding that DOD plans to change its approach and anchor its plans in an enterprise architecture. If the department's future plans are upgraded to provide a departmentwide strategic view of the financial management challenges facing the department, along with planned corrective actions, these plans can serve as an effective tool not only to help guide and direct the department's financial management reform efforts, but also to help maintain oversight of the department's financial management operations. Going forward, this Subcommittee's annual oversight hearings, as well the active interest and involvement of other cognizant defense and oversight committees in the Congress, will continue to be key to effectively achieving and sustaining DOD's financial management and related business process reform milestones and goals.

Given the size, complexity, and deeply engrained nature of the financial management problems facing DOD, heroic end-of-the year efforts relied on by some agencies to develop auditable financial statement balances are not feasible at DOD. Instead, a sustained focus on the underlying problems impeding the development of reliable financial data throughout the department will be necessary and is the best course of action. In this context, the Congress recently enacted the fiscal year 2002 National Defense Authorization Act, which contains provisions that will provide a framework for redirecting the department's resources from the preparation and audit of financial statements, which are acknowledged by DOD leadership to be unauditable, to the improvement of DOD's financial management systems and financial management policies, procedures, and internal controls. Under this new legislation, the department will also be

³¹GAO-01-244.

required to report to the Congress on how resources have been redirected and the progress that has been achieved. This reporting will provide an important vehicle for the Congress to use in assessing whether DOD is using its available resources to best bring about the development of timely and reliable financial information for daily decision making and transform its financial management as envisioned by the Secretary of Defense.

In conclusion, we support Secretary Rumsfeld's vision for transforming the department's full range of business processes. Substantial personal involvement by the Secretary and other DOD top executives will be essential to change the DOD culture that has over time perpetuated the status quo and been resistant to a transformation of the magnitude envisioned by the Secretary. Comptroller Zakheim, as the Secretary's leader for financial management modernization, will need to have the ability to make the tough choices on systems, processes, and personnel, and to control spending for new systems across the department, especially where new systems development is involved. Processes will have to be reengineered, and hierarchical, process-oriented, stovepiped, and internally focused approaches will have to be put aside. The past has taught us that well-intentioned initiatives will only succeed if there are the right incentives, transparency, and accountability mechanisms in place.

The events of September 11 and other funding and asset accountability issues associated with the war on terrorism, at least in the short term, may dilute the focused attention and sustained action that are necessary to fully realize the Secretary's transformation goal, which is understandable given the circumstances. At the same time, the demand for increased Defense spending, when combined with the government's long-range fiscal challenges, means that solutions to DOD's business systems problems are even more important. As the Secretary has noted, billions of dollars of resources could be freed up for national defense priorities by eliminating waste and inefficiencies in DOD's existing business processes. Only time will tell if the Secretary's current transformation efforts will come to fruition. Others have attempted well-intentioned reform efforts in the past. Today, the momentum exists for reform. But, the real question remains, will this momentum continue to exist tomorrow, next year, and throughout the years to make the necessary cultural, systems, human capital, and other key changes a reality? For our part, we will continue to work constructively with the department and the Congress in this important area.

Mr. Chairman, this concludes my statement. I would be pleased to answer any questions you or other members of the Subcommittee may have at this time.

Contacts and Acknowledgments

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